Government of Malaysia v South East Asia Insurance Bhd

FEDERAL COURT (KUALA LUMPUR) — CIVIL APPEAL NO 01-5 OF 1998(W)
CHONG SIEW FAI CJ (SABAH AND SARAWAK), MOHAMED DZAIDDIN AND ABDUL MALEK AHMAD FCJJ
26 JUNE 2000

***Contract** — Performance bond — Distinction between conditional and unconditional 'on demand' guarantee — Whether sufficient demand in compliance with bond — Whether proof of damage required before liability under bond arose*

The appellant entered into a contract with a contractor for construction and completion of a beach restoration works. In consideration of the due performance of the contract, the respondent gave the appellant 'Gerenti Perlaksanaan' ('the performance bond') for RM420,645 and an insurance guarantee against advance payment for RM1,069,035. Subsequently, the appellant discovered that the contractor had defaulted in the completion of the works. The appellant sent a notice to the respondent demanding payment under the performance bond and the insurance guarantee. The respondent failed to respond to the demand and the appellant instituted civil action against the respondent. The appellant's application for a summary judgment against the respondent was dismissed by the registrar. On appeal, the High Court reversed the registrar's decision and gave summary judgment against the respondent. On the further appeal, the Court of Appeal found that there were triable issues and allowed the respondent's appeal. The appellant appealed. The appellant submitted that the performance bond was an on demand bond and not a conditional one as found by the Court of Appeal. The respondent submitted that as the performance bond was a guarantee, proof of damage and not mere assertion thereof was required before liability under the bond arose.

Held, allowing the appeal:

(1) The meaning of para 2 of the performance bond was that the demand must assert a failure to perform the contract. The notice of termination of the contract served on the contractor expressly mentioned about the contractor's breach under para 51(a) of the contract, ie failure to execute the works in accordance with the contract (see pp 631F–H, 632F).

(2) Reading the notice of demand as a whole, it was reasonable to conclude that it complied with para 2 of the performance bond because the particulars in para 2.1 of the notice referred to the amount which the respondent was required to pay as damages for the contractor's breach of the contract. Accordingly, there was sufficient demand made in compliance with para 2 of the performance bond (see pp 632H–633H).

(3) On its true construction, the performance bond was an unconditional bond or an 'on demand' bond and all that was required to activate it was a written demand. It was simply a performance bond whereby the respondent guaranteed performance by the contractor of the works under the contract, and in the event of non-performance or any breach thereof, the respondent undertook to pay the appellant a sum not exceeding RM420,645 upon a formal demand (see p 636B–C).

(4) Paragraph 1 of the insurance guarantee was so drafted that the guarantor shall become liable merely when demand was made by the appellant notwithstanding a contestation or protest by the contractor or the guarantor or by any third party. It was clear that the overall purpose of the insurance guarantee was the reimbursement of the advance payment. The words 'notwithstanding any contestation or protest by the contractor or by ourselves or by any other third party' in para 1 did not alter the fact that the money was payable on a written demand under and pursuant to the insurance guarantee. Therefore, on its true construction, the insurance guarantee was an on demand performance bond (see p 636H–637B).

[Bahasa Malaysia summary

Perayu telah memasuki kontrak dengan kontraktor untuk pembinaan dan penyiapan kerja-kerja pemulihan pantai. Sebagai balasan bagi perlaksanaan kontrak tersebut, responden telah memberikan perayu satu gerenti perlaksanaan bagi nilai sebanyak RM420,645 dan satu gerenti insurans terhadap pembayaran pendahuluan sebanyak RM1,069,035. Kemudiannya, perayu mendapati bahawa kontraktor tersebut telah ingkar dalam penyiapan kerja-kerja tersebut. Perayu telah mengirimkan satu notis kepada responden dengan menuntut pembayaran di bawah gerenti perlaksanaan dan juga gerenti insurans tersebut. Responden gagal untuk membalas tuntutan tersebut dan perayu telah memulakan tindakan sivil terhadap responden. Permohonan perayu untuk penghakiman terus terhadap responden telah ditolak oleh pendaftar. Ketika rayuan, Mahkamah Tinggi telah mengakaskan keputusan pendaftar tersebut dan memberikan penghakiman terus terhadap responden. Atas rayuan yang seterusnya, Mahkamah Rayuan mendapati bahawa terdapatnya isu-isu yang boleh dibicarakan dan telah membenarkan rayuan responden. Perayu telah merayu. Perayu berhujah bahawa gerenti perlaksanaan tersebut merupakan suatu bon ke atas tuntutan dan bukan merupakan suatu bon bersyarat seperti mana yang didapati oleh Mahkamah Rayuan. Responden berhujah bahawa oleh kerana bon perlaksanaan merupakan satu gerenti, bukti gantirugi dan bukan semata-mata penegasannya diperlukan sebelum tanggungan di bawah bon tersebut berbangkit.

Diputuskan, membenarkan rayuan tersebut:

(1) Maksud perenggan 2 gerenti perlaksanaan tersebut adalah bahawa tuntutan semestinya menegaskan suatu kegagalan untuk melaksanakan kontrak itu. Notis penamatan kontrak yang telah disampaikan ke atas kontraktor tersebut menyebut secara nyata mengenai keingkaran kontraktor di bawah perenggan 51(a) akan kontrak tersebut, iaitu kegagalan untuk menyempurnakan kerja-kerja tersebut mengikut kontrak (lihat ms 631F–H, 632F).

(2) Membaca notis tuntutan tersebut secara keseluruhannya, adalah wajar untuk memutuskan bahawa notis tersebut telah mematuhi perenggan 2 gerenti perlaksanaan tersebut kerana butir-butir dalam perenggan 2.1 notis tersebut merujuk kepada jumlah yang responden dikehendaki bayar sebagai gantirugi kerana keingkaran kontraktor akan kontrak tersebut. Sehubungan itu, terdapat tuntutan mencukupi yang dibuat dalam mematuhi perenggan 2 gerenti perlaksanaan tersebut (lihat ms 632H–633A).

(3) Menurut pembentukannya yang sebenar, gerenti perlaksanaan tersebut merupakan satu bon tanpa syarat atau satu 'on demand' bon dan apa yang dikehendaki untuk mengaktifkannya adalah satu tuntutan bertulis. Ia adalah semata-mata satu bon perlaksanaan di mana responden menggerentikan perlaksanaan oleh kontraktor akan kerja-kerja di bawah kontrak tersebut, dan sekiranya berlaku ketidak-laksanaan atau sebarang keingkaran terhadapnya, responden telah mengakujanji untuk membayar perayu satu jumlah yang tidak melebihi RM420,645 atas satu tuntutan rasmi (lihat ms 636B–C).

(4) Perenggan 1 insurans gerenti tersebut telah diderafkan sedemikian rupa hinggakan penggerenti akan menjadi bertanggungan hanya apabila tuntutan dibuat oleh perayu meskipun adanya satu pertikaian atau bantahan oleh kontraktor atau penggerenti atau oleh mana-mana pihak ketiga. Adalah jelas bahawa tujuan menyeluruh insurans gerenti tersebut adalah pembayaran balik akan bayaran pendahuluan. Perkataan-perkataan 'notwithstanding any contestation or protest by the contractor or by ourselves or by any other party' dalam perenggan 1 tidak mengubah hakikat bahawa wang kena dibayar atas satu tuntutan bertulis di bawah dan selaras dengan insurans gerenti tersebut. Oleh itu, atas pembentukan sebenarnya insurans gerenti tersebut merupakan bon perlaksanaan atas tuntutan (lihat ms 636H–637B).]

Notes

For cases on performance bond generally, see 3 *Mallal's Digest* (4th Ed, 1997 Reissue) paras 2674–2682.

Cases referred to

Attaleia Marine Co Ltd v Bimeh Iran (Iran Insurance Co) [1993] 2 Lloyd's Rep 497 (refd)

China Airlines Ltd v Maltran Air Corp Sdn Bhd (formerly known as Maltran Air Services Corp Sdn Bhd) & Anor [1996] 2 MLJ 517 (refd)

Esal (Commodities) Ltd v Oriental Credit Ltd; Banque du Caire SA v Wells Fargo Bank NA [1985] 2 Lloyd's Rep 546 (refd)

Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149 (refd)

Guyana and Trinidad Mutual Life v RK Plummer [1988] LRC (Comm) 548, 553 (refd)

IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank [1990] 2 Lloyd's Rep 496 (refd)

Nanyang Insurance Co (M) v Chin Kim Hin & Wong Siew Kong High Court, 19 September 1991 (unreported) (refd)

Teknik Cekap Sdn Bhd v Public Bank Bhd [1995] 3 MLJ 449 (refd)

Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd [1995] 3 All ER 737 (refd)

Legislation referred to

Rules of the High Court 1980 O 14

Appeal from: Civil Appeal No W–01–142 of 1995 (Court of Appeal, Kuala Lumpur)

Chan Seong Gnoh (Senior Federal Counsel, Ministry of Agriculture) for the appellant.

M Pathmanathan (*Yusof Khan & Pathmanathan*) for the respondent.

Mohamed Dzaiddin FCJ (delivering judgment of the court): This appeal concerns the interpretation of a performance bond ('Gerenti Perlaksanaan') and an insurance guarantee both dated 16 May 1991 given by the respondent to the appellant for the due performance of contract works by Jasib Shipyard & Engineering (M) Sdn Bhd ('the contractor') under a contract no PPS 13/90 dated 25 January 1992 ('the said contract').

Leave was granted by this court on 4 August 1998 to determine whether the said performance bond and the insurance guarantee are conditional or on demand bonds.

Background

Briefly, the facts are as follows. On 25 January 1992 the contractor entered into the said contract with the appellant to construct and complete the partially completed beach restoration works between Sungai Terengganu and Kuala Ibai, Kuala Terengganu. In consideration of the due performance of the said contract the respondent gave the appellant Gerenti Perlaksanaan (performance bond) for RM420,645 and an insurance guarantee against advance payment for RM1,069,035.

Sometime in November 1992, the appellant discovered that the contractor had defaulted in the completion of the works. Hence, by AR registered letter dated 30 November 1992 the appellant terminated the said contract with a copy sent to the respondent. Consequently, on 12 December 1992, the appellant sent a notice to the respondent demanding payment of RM420,645 under the Gerenti Perlaksanaan and RM1,069,035 under the Insurance Guarantee. Since the respondent failed to respond to the above demand, the appellant instituted civil action against the respondent for payment of the aforesaid sum. This was followed by an application for summary judgment under O 14 of the Rules of the High Court 1980.

At the High Court level, the registrar dismissed the application, but on appeal, the learned High Court judge reversed the registrar's decision and gave summary judgment against the respondent. On further appeal, the Court of Appeal on 24 September 1996 found that there were triable issues in the case and allowed the respondent's appeal, set aside the learned judge's decision and restored the decision of the learned registrar.

The issue here and in the Court of Appeal is on the construction of the Gerenti Perlaksanaan and the Insurance Guarantee against advance payment. With respect to the Gerenti Perlaksanaan, paras 1 and 2 provide:

> (1) Jika kontraktor (melainkan ... layak) mungkir melaksanakan kontrak mengenai apa-apa perkara atau melakukan apa-apa perlanggaran terhadap kewajipannya di bawah kontrak, maka Kerajaan akan, jika perlu, memberi penggerenti peluang untuk berbincang sebelum sesuatu keputusan dibuat.
>
> (2) Penggerenti akan membayar gantirugi kepada Kerajaan sebanyak dan setakat RM420,645 dalam tempoh tiga bulan selepas menerima satu notis bertulis mengkehendaki penggerenti membayar kepada Kerajaan apa-apa perlanggaran oleh kontraktor terhadap kewajipannya di bawah kontrak dengan sentiasa tertakluk bahawa segala apa-apa amaun wang bayaran oleh penggerenti tidak melebihi had yang disebutkan dalam perenggan ini.

The Court of Appeal held there were triable issues with regard to the construction of the documents. In its judgment (at p 241 of the appeal record) the court held:

> From the wordings of both the clauses above, it would appear that the liability under cl 2 would only arise after the breach mentioned in cl 1 occurs. Therefore the question as to whether the performance bond is a conditional one or an on demand one becomes an issue and there ought to be a trial to determine this which in turn will affect the validity of the notice issued by the respondent.

It concluded (at p 242):

> We are satisfied that the bond itself specifies the circumstances under which a demand can be made. It requires more than a mere demand or a demand simpliciter to trigger payment. The demand also had to assert the basis of the claim (see *Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449).

> The respondent has not shown whether there had been any breach committed by the contractor, something which can only be determined after a full trial.

Rival submissions

The English translation of para 2 of the performance bond reads as follows:

> The guarantor shall pay damages to the Government a sum not exceeding RM420,645 within three months upon receipt of a written notice demanding that the guarantor pays the Government for any breach of the contractor's obligations under the contract, provided always that the amount payable shall not exceed the amount stipulated in this paragraph.

The primary submission of Pn Chan, for the appellant, was that the Gerenti Perlaksanaan is an on demand bond and not a conditional one as found by the Court of Appeal. Once a proper demand asserting the basis of the claim has been made to the guarantor, the latter must pay the sum demanded. In the present case, there was no requirement for the appellant to prove the breach. It was sufficient to show the basis of the demand and the demand given to the respondent was a proper and sufficient one. Puan Chan relied on *Esal (Commodities) Ltd v Oriental Credit Ltd; Banque du Caire SA v Wells Fargo Bank NA* [1985] 2 Lloyd's Rep 546 (CA) which was followed by this court in *China Airlines Ltd v Maltran Air Corp Sdn Bhd (formerly known as Maltran Air Services Corp Sdn Bhd) & Anor* [1996] 2 MLJ 517. In addition, she cited the following authorities: *IE Contractors Ltd v Lloyds Bank plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496; *Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449; *Nanyang Insurance Co (M) v Chin Kim Hin & Wong Siew Kong* [High Court decision (unreported) dated 19 September 1991]; *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149.

With respect to the Insurance Guarantee, Pn Chan submitted that this was also an on demand performance bond. What was disputed by the Court of Appeal was the amount due to the contractor under the progress payment, where the court observed that the interim payments had not been taken into account by the appellant when they claimed for the full sum of RM1,069,035 in the amended statement of claim and O 14 summons.

The upshot of Pn Chan's argument was that on the true construction of para 2 of the performance bond and based on the above authorities, the said bond is an on demand bond.

Hence, the Court of Appeal erred in its interpretation that it is a conditional bond. En Pathmanathan, for the respondent, submitted that on the face of the Gerenti Perlaksanaan, this is not an on demand bond but a conditional one. However, the thrust of counsel's argument is that as the performance bond in the instant appeal is a guarantee, both *Esal* and *IE Contractors'*, relied by Pn Chan are no longer good law as they have been overruled by the English House of Lords in *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1995] 3 All ER 737. The ratio of the case is that as the bond amounted to a guarantee, proof of damage and not mere assertion thereof was required before liability under

A the bond arose. Therefore, in the circumstances of the case, the appellant must prove their loss and not merely assert that the sum of RM420,645 was the amount of damages payable to them under para 2 of the Gerenti Perlaksanaan.

Pn Chan in her reply contended that *Trafalgar House* did not overrule
B but distinguished *Esal.*

Deliberation

It is not disputed that both the Gerenti Perlaksanaan and the Insurance Guarantee are performance bonds. This court in *China Airlines*, quoting
C *The Modern Law of Guarantee* by O'Donovan & Phillips (2nd Ed) stated that there are two types of performance bond. The first type is a conditional bond whereby the guarantor becomes liable upon proof of a breach of the terms of the principal contract by the builder and the proprietor sustaining loss as a result of such breach. The second type is an unconditional or 'on-demand' performance bond which is so drafted that
D the guarantor will become liable merely when demand is made upon the guarantor by the proprietor with no necessity for the proprietor to prove any default by the principal in performance of the principal contract.

The issue in the present appeal is whether the two documents are conditional or on demand bonds. In deciding this question the court will consider the overall purpose of the contractual relationship (*Attaleia Marine*
E *Co Ltd v Bimeh Iran (Iran Insurance Co)* [1993] 2 Lloyd's Rep 497 at p 502) and the factual matrix of the case (*Guyana and Trinidad Mutual Life v RK Plummer* [1988] LRC (Comm) 548 at p 553 (CA); *IE Contractors.*) Indeed, we are reminded by Staughton LJ in *IE Contractors* at p 499 that in interpreting the written documents 'it must never be forgotten that the task
F of the court is to construe the documents which were used in this case, and not any others'.

We shall first deal with the Gerenti Perlaksanaan.

The material part of para 2 of the Gerenti Perlaksanaan reads:

> The guarantor shall pay damages to the Government a sum not exceeding
G RM420,645 within three months *upon receipt of a written notice demanding that the guarantor pays the Government for any breach of the contract's obligations under the contract*, ... (Emphasis added.)

In construing the above para, we would adopt the approach taken by Lord Justice Ackner (as he then was) in *Esal*, p 550. There are three possible
H meanings which can be given to the above paragraph. First, no more than a mere written demand is required. Secondly, the demand must assert a failure to perform the contract. Thirdly, because of the word 'damages', proof thereof and not mere assertion is required before liability under the bond arises. In our view, the second possibility is the answer because in addition to the demand made, the paragraph requires the Government to
I state the breach of the contractor's obligations under the contract.

In the instant case, the demand made by the appellant on the respondent for the above performance bond and the Insurance Guarantee

is contained in the letter dated 12 December 1992 (p 180 of the appeal record). The material part reads as follows:

> Adalah saya diarah memaklumkan kepada pihak tuan bahawa Kontraktor telah gagal menyiapkan kerja-kerja untuk Kontrak yang tersebut di atas. Sila rujuk surat Notis untuk Penamatan Pengambilan Kerja Kontraktor dari pejabat ini bil (76) dim PPS 07/4T/2/50 bertarikh 30 November 1992 yang telah dikemukakan kepada pihak tuan sebelum ini.
>
> 2 Lanjutan dari pengeluaran surat penamatan tersebut, pejabat ini menuntut dari pihak tuan ke atas gerenti-gerenti seperti berikut:
>
> 2.1 Gerenti Perlaksanaan
> No Gerenti: HH1/1/04641/0702
> Nilai : RM420,645
>
> 2.2 Gerenti Bayaran Wang Pendahuluan
> No Gerenti: HH1/1/04641/0704
> Nilai : RM1,069,035

Literally translated, it reads:

> I am directed to inform you that the contractor had defaulted in completing the works stated above. Please see our notice of termination to the Contractor ref: (76) dlm PPS 07/4T/2/50 dated 30 November 1992 which we served on you earlier.
>
> Following the above notice of termination, we hereby demand from you payment under the following guarantees:
>
> 2.1 Gerenti Perlaksanaan
> No Gerenti: HH1/1/04641/0702
> Nilai : RM420,645
>
> 2.2 Gerenti Bayaran Wang Pendahuluan
> No Gerenti: HH1/1/04641/0704
> Nilai : RM1,069,035

The notice of termination of the contract (p 177 of the appeal record) served on the contractor expressly mentioned about the contractor's breach under para 51(a) of the said contract, ie failure to execute the said works in accordance with the said contract.

Therefore, from the above notice, we find there is a clear assertion that the contractor had failed to perform his contract under para 51(a) of the said contract.

The next question that arises is whether para 2 of the Gerenti Perlaksanaan requires anything more than a demand asserting the breach without the appellant proving the loss in view of the opening words: 'The guarantor shall pay damages to the Government ...'? It is to be noted that the amounts payable under the two bonds are set out in para 2 of the letter of demand. But, in the letter of demand there is no express assertion that the amounts demanded are in respect of damages which the appellant had suffered. Reading the notice of demand as a whole, it is reasonable to conclude that it complies with para 2 of the Gerenti Perlaksanaan because the particulars in para 2.1 of the notice refers to the amount specified in para 2 of the bond and in substance is the amount which the respondent is

required to pay as damages for the contractor's breach of the said contract. Accordingly, there was sufficient demand made in compliance with para 2 of the Gerenti Perlaksanaan.

In support of the above conclusion, we would rely on *IE Contractors'*, which was followed by this court in *Esso Petroleum*. The terms of the performance bonds in *IE Contractors* issued by Rafidain Bank, inter alia, stated:

> (1) We have issued in your favour, as beneficiaries, this letter of guarantee to indemnify you against any damages that you may sustain, up to an amount of ID211,896 (Iraqi Dinars Two Hundred Eleven Thousand Eight Hundred and Ninety Six only).
>
> (2) Covering Performance of Contract Guarantee covering damages which you claim are duly and properly owing to your organisation by GKN Contractors Ltd, under the terms of the Contract for a Slaughterhouse at Duhouk made on 12 June 1978 between you and GKN Contractors Ltd and Ross Poultry Ltd,
>
> (3) We undertake to pay you unconditionally the said amount on demand, *being your claim for damages brought about by the above named principal.* (Emphasis added.)

The demand made on all three bonds reads as follows:

> In view of the non-discharge by the company of its contractual obligations in making good the deficiencies of the slaughter houses of Al-Quadisiya, Karbala and Dohuk, we request withdrawal of the under-mentioned Gurantees and transference of their amounts to this Establishment.

The amounts of the performance bonds were then set out.

Leggatt J held, inter alia, that the demand made was invalid for not stating that it was 'for damages etc' as set out in the bonds. Allowing the appeal, the Court of Appeal declined to adopt such a 'strict compliance approach' of Leggatt J. Staughton LJ, delivering the judgment of the court held at pp 501–502:

> On any view there was a plain assertion that the contractors had not fulfilled their obligations. But there was no express assertion that the amounts claimed represented no less than the damage which the employers had suffered.
>
> Two questions arise: first, did the performance bonds require anything more than mere demands? Secondly, if so, did the demand presented assert such facts as the performance bonds required that it should assert? Mr Justice Leggatt answered these questions (1) 'Yes', and (2) 'No', and held that *Rafidain* were not liable to the employers.
>
> In my judgment the demand is required to state that it is a claim for damages brought about by the contractors. Thus I agree with the Judge that something more than a mere demand was needed, although not exactly with the requirement that he adopted.
>
> It is arguable that some further assertion is required by para 5 of the performance bonds. But on a fair reading of the document as a whole I do not think that the rigmarole in the proviso which that paragraph contains was required to be repeated verbatim, or at all.

> *Did the demand made comply with the requirements of the bonds as I have construed them? It certainly asserted breaches of contract, but it did not in terms mention damages.* It is here that the degree of strict compliance necessary becomes important. I resolutely decline to interpret these bonds as saying that Rafidain will pay if, but only if, the precise words in para 3 are to be found in the demand. They were issued by one Iraqi concern to another, written in both English and Arabic, in language which is both prolix and vague. I cannot attribute to the parties an intention that there had to be a strict degree of compliance.
>
> *In my judgment the demand made did say in substance, although not in express words, that what it claimed was damages for breach of contract. Accordingly I would hold that it was a sufficient demand upon the performance bonds.* (Emphasis added.)

Encik Pathmanathan had submitted that *IE Contractors* is no longer good law as it had been overruled by *Trafalgar House* where the House of Lords decided that on its true construction, the bond in the case was a 'guarantee' in which proof of damage and not mere assertion thereof was required before liability under the bond arose and the defendants would be entitled to raise all questions of sums due and cross-claims which would have been available to sub-contractors in an action against them for damages.

Trafalgar House concerned the effect of a bond granted to a main contractor by a sub-contractor who was unable to complete the sub-contract after the receivers had been called in. The bond was drafted in archaic English which prompted Lord Jauncey to comment (ibid, p 745):

> I find great difficulty in understanding the desire of commercial men to embody so simple an obligation in a document which is quite unnecessarily lengthy, which obfuscates its true purpose and which is likely to give rise to unnecessary arguments and litigation as to its meaning.

It is sufficient to refer to the headnote which summarizes the facts of the case and the issues. The plaintiff contractors entered into a contract with a local authority for the construction of a leisure complex. The plaintiffs engaged sub-contractors for groundworks and required them to provide a bond for 10% of sub-contract value of £1,012,851.31. The sub-contractors entered into such a bond with the defendants, described as 'the surety', under which the surety's obligation was null and void if the sub-contractors fulfilled the terms of the contract or if on default by the sub-contractors the surety 'shall satisfy and discharge the damages sustained by' the main contractors up to the amount of the bond. Before they completed work under the sub-contract the sub-contractors went into receivership and were unable to continue. The plaintiffs completed the works themselves and issued a writ against the defendants claiming £101,285 under the bond and applied for summary judgment. The official referee refused the defendants leave to defend and entered summary judgment. The defendants' appeal to the Court of Appeal was dismissed on the grounds: (i) that the purpose of the bond was to provide immediate funds for the plaintiffs in the event of failure of performance by the sub-contractors; (ii) that the bond was not a guarantee in the ordinary sense whereby the guarantor agreed to 'see to it' that the sub-contractors' obligation would be performed but imposed on

A the surety an independent obligation to pay, on demand being made in good faith by the plaintiffs, a gross sum of damages representing the additional expenditure incurred by the plaintiffs as a result of the sub-conractors' breach; and (iii) that in calculating that sum no account was to be taken of debts and credits, including the value of any set-offs and counterclaims due to or by the parties.

B

Two principal issues arose in the appeal from the decision of the Court of Appeal. One, whether the bond was a guarantee, and secondly, whether the affidavits lodged by the appellants raised an issue to be tried. For our purpose, the first issue is crucial.

C Lord Jauncey, delivering the opinion of the House, approached the issue by considering whether the bond in the case without the second part of the condition was a guarantee, and if so, whether the addition of that second part altered the position. The second part of the condition was in respect of payment of damages sustained by the plaintiffs up to the amount of the bond. After considering several authorities, his Lordship found that D the Court of Appeal was in error in concluding that the bond was not a guarantee but was akin to an on demand bond. His Lordship held (ibid, p 743):

> I have therefore no hesitation in concluding that the Chambers bond without the second part of the condition would amount to a guarantee and that the E appellants would be entitled to raise all questions of sums due and cross-claims which would have been available to Chambers in an action against them for damages.

It would appear to us that the above dictum of the House of Lords was based on the interpretation of a performance bond peculiar to the case, after having taken the view that on its true construction the bond was a guarantee F and that his Lordship's conclusion was made upon the basis that the bond was construed without the second part of the condition which provided for the payment of damages sustained by the plaintiffs up to the amount of the bond.

It is trite law that in every case the terms of the performance bond need G to be carefully considered. We find the text of the bond in *Trafalgar House* is not identical to that of para 2 of the Gerenti Perlaksanaan. Having read the House of Lord's judgment, we also found that *IE Contractors* was not referred to or discussed by Lord Jauncey. His Lordship did, however, refer to *Esal* where he observed that in recent years there has come into existence a creature described as an 'on demand' bond in terms of which a creditor is H entitled to be paid merely on making a demand for the amount of the bond. All that was required to activate it was a demand by the creditor stated to be on the basis of the event specified in the bond.

With reference to *Trafalgar House*, his Lordship stated (at p 743):

I > In this case the Court of Appeal by determining that the appellants' liability under the bond arose on the failure of Chambers to complete the contract followed by a demand in good faith for the amount of the damages which they claim to have suffered were effectively treating it as a type of on demand bond.

From the above observation of Lord Jauncey, we agree with Pn Chan that *Trafalgar House* did not overrule *Esal* and *IE Contractors*, but merely distinguished *Esal* when his Lordship commented that 'the Court of Appeal were effectively treating it as a type of on demand bond.' In addition, the latest edition of *The Modern Law of Guarantee* (3d Ed, 1996) in its chapter on 'Performance Bond' discussed at length *IE Contractors*, but said nothing about the effect of *Trafalgar House* on the former, let alone mentioning it in the footnote.

In our judgment, on its true construction this Gerenti Perlaksanaan is an *unconditional bond* or an *on demand bond* and all that is required to activate it is a written demand (*Esal*). It is simply a performance bond whereby the insurance company guarantees performance by the Contractor of the works under the said contract, and in the event of non-performance or any breach of the terms thereof, the insurance company undertakes to pay the Government a sum not exceeding RM420,645 upon a formal demand.

With respect to the Insurance Guarantee, the relevant paragraphs state as follows:

> We, the undersigned, at the request of the contractor irrevocably undertake and guarantee to the Government that:
>
> 1 We shall pay to the Government free of interest, the sum of RM1,069,035 (Ringgit Malaysia: ONE MILLION SIXTY-NINE THOUSAND AND THIRTY FIVE ONLY ...) the advance payment mentioned above or such part thereof as shall not have already been recovered by the Government pursuant to cl 3 or 4 hereof and such sum shall be paid on the Government's demand notwithstanding any contestation or protest by the contractor or by ourselves or by any other third party.
>
> 2 ...
>
> 3 Subject to cl 4, our responsibility for paying the said sum of RM1,069,035 (Ringgit Malaysia: ONE MILLION SIXTY-NINE THOUSAND AND THIRTY FIVE ONLY ...) shall be automatically reduced by the amount or amounts of any payments made by us to the Government in respect of this guarantee.
>
> 4 The said sum which we guarantee to pay to the Government shall be reduced automatically in proportion to deductions made by the Government out of the progress payments due to the contractor for repayment of the advance payment so made. This Guarantee shall be cancelled immediately after the whole of the advance payment have been released through payments by us or through deductions made out of the progress payments due to the contractor, or after the expiry of the period mentioned in cl 5, whichever is the earlier.

Paragraph 1 is so drafted that the guarantor shall become liable merely when demand is made by the Government notwithstanding any contestation or protest by the contractor or the guarantor or by any third party. It is clear that the overall purpose of the Insurance Guarantee is for the reimbursement of the advance payment of RM1,069,035, less whatever amounts of payment made by the guarantor and deductions out of the progress payments under paras 3 and 4 upon a written demand made. In

Esal, the bank 'undertake to pay the said amount on your written demand in the event that the supplier fails to execute the contract'. It was held that the latter words did not alter the fact that the moneys were payable upon a written demand. Likewise, in the present case, the words 'notwithstanding any contestation or protest by the contractor or by ourselves or by any other third party' in para 1 above, do not alter the fact that the money is payable on a written demand under and pursuant to the said Insurance Guarantee. Therefore, on its true construction this Insurance Guarantee is an on demand performance bond.

The Court of Appeal in its judgment at p 243 of the appeal rcord seemed to agree that this Insurance Guarantee is an on demand guarantee. However, what the court disputed was the amount claimed by the appellant. Relying on paras 3 and 4 of the bond and the particulars of interim repayments in the respondent's defence, the court held that these repayments were not taken into account in the appellant's amended statement of claim where the full sum of RM1,069,035 was claimed.

After looking at the pleadings and opposing affidavits in the O 14 application, we agree with the observation of the Court of Appeal.

Conclusion

Our answer to the question raised in this appeal is that on the true construction, both documents are *unconditional* or *on demand* bonds.

For reasons stated, we allow this appeal and make the following orders:

(1) the respondent shall pay the appellant the sum of RM420,645 under the Gerenti Perlaksanaan with interest at the rate of 8%pa from the date of judgment ie 12 May 1995 until realization;

(2) the amount due and payable to the appellant under the Insurance Guarantee be assessed by the Registrar of the High Court taking into account deductions already made by the appellant from the progress payments due to the contractor;

(3) costs here and below; and

(4) with liberty to apply.

Appeal allowed.

Reported by Jafisah Jaafar